Australian Income Securities Research

Monthly Review November 2012

1.	Income Security Best Ideas	2
2.	Rate Sheet at 22 November 2012	3
3.	Recommendation Changes since Last Month	4
4.	Fixed Income Review	4
5.	New Issues, Maturities and Resets	6
6.	Outlook	6
7.	Major Bank Income Securities	8
8.	Other Floating-Rate Income Securities	10
9.	Fixed-Rate Income Securities	12
10.	Glossary	13

1. Income Security Best Ideas

ASX Code	Name	Recommendation	Risk	Gross Running Yield
SUNPC	Suncorp CPS II	Accumulate	Medium	8.11%

Suncorp CPS II (ASX Code: SUNPC) are Convertible Preference Shares issued by Suncorp Group. They are perpetual, unsecured, subordinated notes with an expected maturity (known as the mandatory exchange date) of 17 December 2019. Dividends are fully franked, discretionary, non-cumulative payable quarterly in arrears and based on the 90-day BBSW rate plus 4.65%. On an absolute valuation basis, we believe SUNPC offers good value above our fair margin (trading margin is 4.44% versus our fair margin of 4.25%) and relative to its closest comparable (IAGPC). The security offers a yield to first call of 7.93% and a running yield of 8.11%.

ANZPC	ANZ CPS3	Accumulate	Medium	6.60%

ANZPC are Convertible Preference Shares issued by ANZ with a face value of $100. ANZPC are fully paid preference shares issued by ANZ, which will mandatorily convert into ordinary shares of ANZ on 1 September 2019. They pay non-cumulative, floating rate, fully franked distributions at a 3.10% margin above 180-Day BBSW. Since ANZPC commenced trading on the ASX they have not traded as strongly as the broader bank capital market (Tier 1 and tier 2) and currently offer a trading margin of 3.41% relative to our fair value margin of 2.65%. These securities pay a semiannual dividend which has its next payment date on 1 March 2013.

WBCPC	WBC CPS	Accumulate	Medium	6.69%

WBCPC are Convertible Preference Shares issued by WBC with a face value of $100. WBCPC are fully paid preference shares issued by WBC, which will mandatorily convert into ordinary shares of WBC on31 March 2020. They pay non-cumulative, floating rate, fully franked distributions at a 3.25% margin above 180-Day BBSW. Since WBCPC commenced trading on the ASX they have not traded as strongly as the broader bank capital market (Tier 1 and Tier 2) and currently offer a trading margin of 3.35% relative to our fair value margin of 2.65%. These securities pay a semiannual dividend which has its next payment date on 2 April 2013.

WBCPA	WBC SPS	Accumulate	Medium	5.82%

WBCPA are stapled preferred securities of WBC with a face value of $100. WBCPA are stapled unsecured securities with a mandatory conversion date of 26 September 2013, subject to conversion conditions. They pay non-cumulative, floating rate, fully franked distributions at a 2.40% margin above 90-Day BBSW. These securities offer a good relative value for investors with a relatively short time horizon (less than 1 year). The risk of default and deferral in the next 12 month is considered low.

GMPPA	Goodman PLUS II	Accumulate	Medium	8.03%

Goodman PLUS II are an amended version of Goodman PLUS securities issued by Goodman Group (GMG) with a face value of $100. GMPPA holders have a redemption date of 31 December 2073 with an issuer remarketing date on 31 December 2017. They pay non-cumulative, unfranked distributions at a 3.90% margin above 90-Day BBSW. They are currently trading below our fair value estimate and offer a gross running yield of 8.03% and 9.39% yield to reset.

2. Rate Sheet at 22 November 2012

Code	Recommendation	Price ($)	Issuer	Issue Size ($m)	Years To Maturity	Trading Margin	Running Yield inc Fr	Running Yield ex Fr	Yield to Reset inc Fr	Yield to Reset ex Fr	Dist ($)	Ex Date
AGKHA	UNDER REVIEW	101.50	AGK	650	6.53	3.47%	7.15%	7.15%	6.92%	6.92%	1.84	26/11/2012
ANZHA	HOLD	104.38	ANZ	1509	4.55	2.02%	5.98%	5.98%	5.36%	5.36%	1.53	6/12/2012
ANZPA	ACCUMULATE	100.80	ANZ	1970	4.05	2.79%	6.47%	4.53%	6.20%	4.25%	1.16	26/11/2012
ANZPB	ACCUMULATE	100.00	ANZ	1081	1.55	2.31%	5.90%	4.13%	5.70%	3.97%	1.05	26/11/2012
ANZPC	ACCUMULATE	100.30	ANZ	1340	4.76	3.41%	6.60%	4.62%	6.83%	4.73%	2.27	8/02/2013
AQHHA	ACCUMULATE	103.90	APA	515	5.34	3.92%	7.83%	7.83%	7.44%	7.44%	2.30	17/12/2012
BENPC	HOLD	93.45	BEN	100	1.87	5.68%	5.54%	3.88%	9.58%	7.78%	0.87	17/12/2012
BOQPC	REDUCE	87.80	BOQ	200	-	2.88%	6.13%	4.29%	-	-	2.17	18/09/2012
CBAHA	ACCUMULATE	99.91	CBA	575	3.07	1.24%	4.43%	4.43%	4.60%	4.60%	1.07	31/12/2012
CBAPA	ACCUMULATE	204.45	CBA	2000	1.93	2.47%	6.74%	4.72%	5.82%	3.69%	2.31	18/01/2013
CBAPC	HOLD	104.10	CBA	2000	6.05	3.29%	7.09%	4.96%	6.71%	4.45%	0.79	3/12/2012
CNGHA	ACCUMULATE	103.50	CNG	1000	4.34	2.63%	6.54%	6.54%	6.01%	6.01%	1.65	17/12/2012
CTXHA	HOLD	104.90	CTX	550	4.80	3.72%	7.78%	7.78%	7.20%	7.20%	2.23	3/12/2012
CWNHA	ACCUMULATE	104.40	CWN	532	5.80	4.45%	8.33%	8.33%	7.93%	7.93%	2.01	30/11/2012
ELDPA	HOLD	39.00	ELD	150	-	76.59%	95.36%	66.75%	-	-	0.93	17/06/2009
GMPPA	ACCUMULATE	93.65	GMG	327	5.09	5.69%	8.03%	8.03%	9.39%	9.39%	1.37	10/09/2012
IAGPC	HOLD	100.35	IAG	377	4.43	4.05%	7.45%	5.22%	7.44%	5.15%	2.48	17/04/2013
IANG	ACCUMULATE	102.75	IAG	550	7.05	3.78%	7.40%	5.18%	7.24%	4.90%	1.31	3/12/2012
MBLHB	ACCUMULATE	68.50	MQG	400	-	4.50%	7.56%	7.56%	-	-	1.23	20/12/2012
MQCPA	HOLD	104.81	MQG	600	0.59	-	11.43%	11.43%	10.89	10.89	5.53	15/06/2012
NABHA	ACCUMULATE	71.70	NAB	2000	-	3.42%	6.50%	6.50%	-	-	1.14	24/01/2013
NABHB	HOLD	104.45	NAB	1173	4.56	1.98%	5.98%	5.98%	5.32%	5.32%	1.56	4/12/2012
NFNG	ACCUMULATE	84.00	NUF	251	-	5.57%	8.86%	8.86%	-	-	4.05	28/03/2013
ORGHA	UNDER REVIEW	101.45	ORG	900	4.07	3.97%	7.48%	7.48%	7.44%	7.44%	1.84	10/12/2012
PCAPA	ACCUMULATE	185.70	CBA	1166	3.36	3.54%	4.78%	3.34%	7.11%	5.62%	1.48	21/12/2012
RHCPA	HOLD	103.70	RHC	260	-	4.64%	8.10%	5.67%	-	-	3.20	28/09/2012
SBKPB	HOLD	101.49	SUN	735	0.55	3.05%	6.64%	4.65%	6.43%	3.62%	1.19	28/11/2012
SUNPC	ACCUMULATE	102.50	SUN	560	5.06	4.44%	8.11%	5.68%	7.93%	5.34%	0.61	3/12/2012
SVWPA	ACCUMULATE	84.23	SVW	496	-	6.41%	9.77%	6.84%	-	-	2.81	9/11/2012
TAHHA	HOLD	102.90	TAH	284	1.42	2.39%	7.55%	7.55%	5.69%	5.69%	1.90	1/02/2013
TAHHB	UNDER REVIEW	101.30	TAH	250	4.32	4.01%	7.49%	7.49%	7.48%	7.48%	1.84	10/12/2012
TTSHA	ACCUMULATE	103.50	TTS	195	6.61	2.63%	6.37%	6.37%	6.03%	6.03%	1.62	20/12/2012
WBCHA	HOLD	103.00	WBC	1676	4.74	2.04%	5.99%	5.99%	5.42%	5.42%	1.61	9/11/2012
WBCPA	ACCUMULATE	100.70	WBC	1036	0.83	2.61%	5.82%	4.07%	6.08%	3.96%	1.00	17/12/2012
WBCPB	ACCUMULATE	103.20	WBC	908	1.84	2.70%	7.13%	4.99%	6.02%	3.65%	1.25	17/12/2012
WBCPC	ACCUMULATE	100.60	WBC	1189	5.34	3.35%	6.69%	4.68%	6.75%	4.66%	2.27	18/03/2013
WCTPA	ACCUMULATE	92.37	WBC	763	3.59	3.51%	4.76%	3.33%	7.09%	5.61%	0.76	6/12/2012
WOWHC	HOLD	105.20	WOW	700	3.99	1.86%	6.36%	6.36%	5.23%	5.23%	1.77	12/11/2012

Source: Morningstar (yields) and ASX (prices and ex-dates) - Yields and trading margins above 30% are not displayed.

Ex-dates and distributions are the latest reported by the ASX at the 22 November 2012.

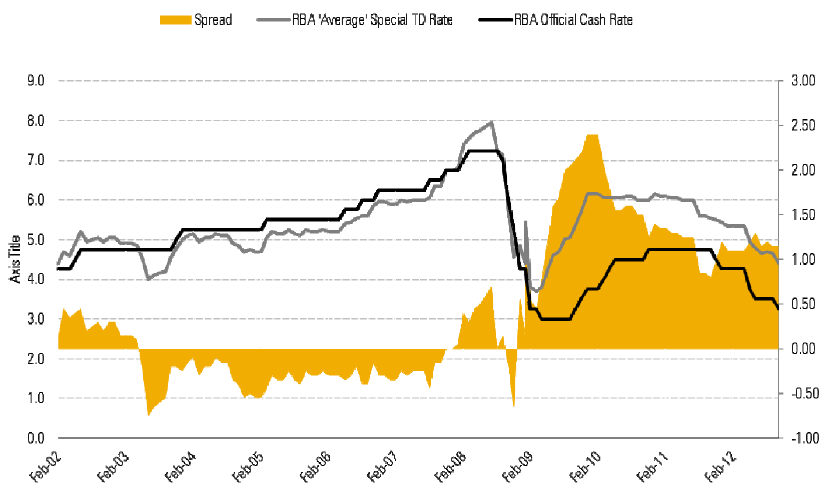
3. Recommendation Changes since Last Month

- On 16 November 2012 we initiated coverage on Suncorp CPS II (ASX Code: SUNPC) with accumulate recommendation. On an absolute valuation basis, we believe SUNPC offers good value, both relative to our fair margin (trading margin is 4.44% versus our fair margin of 4.25%) and its closest comparable (IAGPC) which is trading on a margin of 4.04%. The security offers a yield to first call of 8.11% and a running yield of 7.93%. SUNPC is the fourth hybrid security offered by Suncorp to Australian retail investors but it is the first security issued outside of the banking subsidiary (Suncorp Metway). As general insurance represents the majority of the group's operations it is logical to ensure the group is efficiently capitalised.
- On Friday 9th November we released a Special Report; "Corporate Hybrids: S&P's Review of Equity Credit May Impact Some of Our Recommendations". In this report we outlined the risks on specific listed income securities which may be affected by Standard & Poor's (S&P) proposed changes to its methodology for determining whether to regard hybrid securities as equity or debt. This change has already been implemented for some recent income securities in Australia. It was evident with the inconsistent equity credit allocated to securities issued post June 2012 (i.e. CTXHA) vs. securities issued in the financial year ending June 2012 (i.e. TAHHB, ORGHA). While this structural change ran broadly under the radar. It has a unique effect on an issuer's credit profile and could potentially have an effect on the future performance of specific income securities. Morningstar has contacted the issuers and S&P about the changes and are in the process of reviewing our recommendation on ORGHA, AGKHA and TAHHB. We expect our review to be completed by the 30th November 2012.
- We have extended the coverage period of BENPC, BOQPC, TPAPA, NFNG until 31-Jan-2013 and will cease coverage on these securities from this date.

4. Fixed Income Review

As part of the monthly review, Morningstar is dedicated to giving you the most relevant analysis on the income securities universe. Retail investors have a diverse investable universe (excluding equities) in the domestic income landscape and there are a number of factors which influence these products. Morningstar explains more below.

- **Term Deposits**: The volatility in equity markets as a result of the global financial crisis has led to retail investors flocking to the safety in bank deposits. This came largely in response to the government guarantee being introduced in October 2008 to promote financial system stability. The crisis led to a global change in banking regulation which in turn incentivised banks to attract retail deposits which are regarded as 'sticky money' and the best form of bank funding. Since 2008 the domestic banks have offered very competitive levels to attract new term deposit funding however in the last few months we have begun to see yields falling. This is clearly evident in the below chart. As the official RBA cash rate is reduced so too is the spread offered by banks. From this you can reasonably suggest that banks are nearing their requirement for retail funding as a proportion of their overall funding. Morningstar expects the 'deposit spread' to slowly revert to its long term mean over the next 12 months which will in turn make credit securities more



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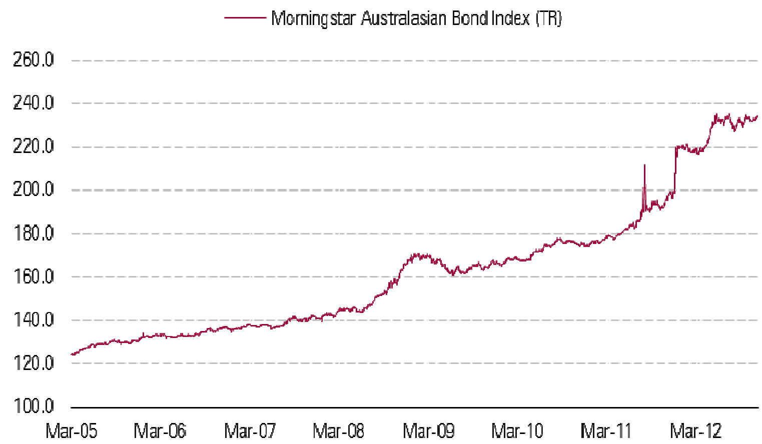
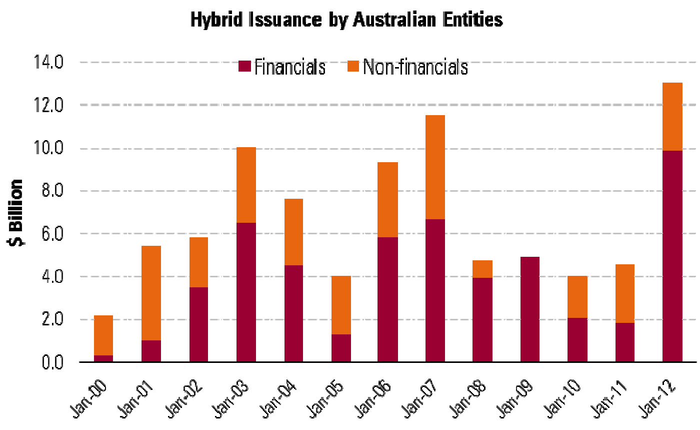
attractive relative to deposits.

- **Government Bond and Money Markets:** Commonwealth Government Securities (CGS) used to be bought and sold on the ASX but this has not been possible since the 1980's. However, with the amendment to the 'Inscribed Stock Act 1911' these securities will be available to trade on the ASX via depositary receipts from early 2013. The supply of Australian government bonds has increased significantly since the onset of the global financial crisis, jumping from AUD 60 billion in 2008 to 234 billion in 2012. The bulk of this increase has come from the CGS market, as the commonwealth government responded to the weaker economy with fiscal stimulus. The flip side of an increase in supply is that foreign central banks have increased their allocation to Australian sovereign debt, (evident by the IMF recently stating that they are considering adding the Australian dollar to the official list of the global reserve currencies. The government is likely to be uncomfortable with this increased reliance on foreign capital and hence it is part of the reasoning behind developing a retail bond market. The government has committed to retaining a "liquid and efficient bond market" and in the 2012 budget implied that this would require CGS on issue of "around 12 to 14 per cent of GDP over time. Morningstar sees this development of this market as a positive step forward for the domestic retail corporate bond market.



- **Inflation Linked Bonds**: Inflation-linked bonds are designed to help protect investors from the negative impact of inflation by contractually linking the bonds' principal and interest payments to the Australian Consumer Price Index. These securities are currently made available to retail investors through the RBA Small Parcel Facility but are also expected to be made available to retail participants as part of the CGS program on the ASX. Capital Indexed Bonds ('CIBS') and Treasury Indexed Bonds ('TIB') are quoted in real yield and hence the difference between the yield on a TIB and nominal yield on standard CGS is the expected rate of inflation. From these points investors can see what the market expects for inflation over a specified time horizon. These securities are designed to protect investor's capital from the effect of inflation. Therefore investors should be conscious of the drivers of inflation expectations including global central bank policy initiatives.

- **Credit Comment:** When we discuss credit we are broadly talking about the credit spread premium applied to all corporate bonds, hybrids and other credit related securities over their relevant benchmark. These securities are subject to changes in trading margins (or credit spreads) which are in turn a function of credit risk and market risk. Estimating the price sensitivity to these changes in trading margin enhances our understanding of the risks of a specific security or a portfolio. This sensitivity estimate is referred to as duration (this can be broken down further into effective and spread duration). Duration as a measure is not linear and hence a change in spread does not equate to an equivalent change in price. Australian hybrids in technical terms are described as short duration primarily because they reset on a quarterly (or semiannual) basis. This means they are not overly sensitive to changes in the benchmark rate (i.e. BBSW) but they are sensitive to changes in the



trading margin. In the past week credit spreads have stabilised following a rally in the prior month. This means the capital price of these securities has increased while maintaining its income capacity. This is the most optimal outcome for investors and is broadly how institutional investors aim to implement their credit strategies.

5. New Issues, Maturities and Resets

- On 19th November 2012 Bank of Queensland (BOQ) announced it had successfully completed the bookbuild for the BOQ Convertible Preference Shares (ASX Code: BOQPD). The issuer increased the size to $250m and priced the deal at 3M BBSW + 5.10% (the lower end of the range). This security does not fit within Morningstar's coverage eligibility criteria and hence will be covered.
- BOQ Perpetual Equity Preference Shares (BOQPC): BOQ has determined not to redeem PEPS on the first optional call date of 17 December 2012 but has offered holders, as at 9 November 2012, the option to convert into the new securities BOQ CPS (ASX Code: BOQPD). In December 2010 Morningstar re-initiated on BOQPC at a reduce recommendation primarily due to the fact that we did not believe the issuer would give holders the option to redeem for cash and the security would remain outstanding. This has proved to be true with the exception of the offer to reinvest in the new BOQ CPS hybrid.
- On 1 November 2012 Bendigo and Adelaide Bank (BEN) announced it had completed the bookbuild for its new Convertible Preference Share offer (ASX Code:BENPD), issuing $269m of Tier 1 capital at 180 day BBSW +5.0%. BENPD commenced trading on the ASX on the 8 November 2012 with the first dividend to be paid on the 13 December 2012. As part of the new security offer existing BENPA holders had the option to roll their investment into the new security but if they did not elect to reinvest BENPA securities were redeemed at par ($100) on 1 November 2012.

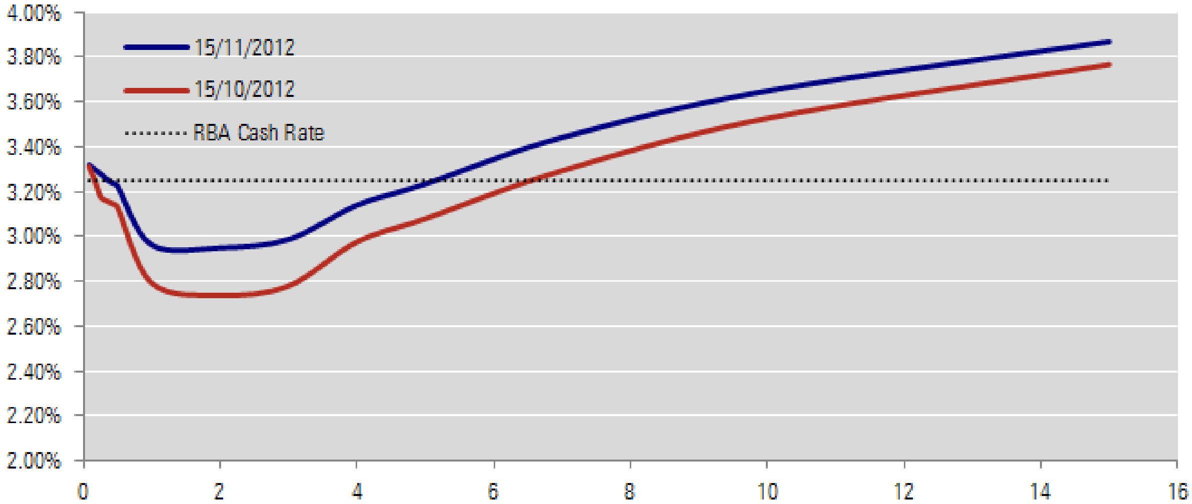
6. Outlook

Over the past month we have seen some stabilisation in interest rate expectations after the RBA Board kept the cash rate on hold in November. In the minutes from the meeting the board suggested that "further easing mat be appropriate in the period ahead". Given the inflation forecast was largely unchanged and the recent improvement in the global economic data (excluding Europe) it seemed appropriate to maintain the official cash rate at 3.25%.

Over the past month interbank cash rate futures had predicted 50-75% chance of a December rate cut. This suggests a December rate cut is by no means a done deal and as discussed in last month's report they are more likely to be reactive rather than proactive when it comes to monetary easing over the next quarter.

The current yield curve suggest that things will get worse before they get better it arguable that foreign investors are artificially deflating yields at the long end (i.e. 10 + years) of the curve. This is part due to the safety of Australian government bonds and partly due to the expectation that yields will continue to drop. This is primarily due to an external view that the outlook for the Australian economy is not particularly favorable. The end of the commodity boom, fiscal contraction policies and the strength in the AUD all suggest that real growth will be difficult in coming years. Morningstar continues to expect rates to drop to a low in 2013 and remain low for an extended period.

Figure 6.1 AUD Swap Rates Annualised



Source: Morningstar/Reuters

	Bank Bill Rate		IR Swap (Fixed Leg)
RBA Cash Rate	3.25%	1 year	2.96%
1 month	3.32%	2 year	2.95%
2 month	3.30%	3 year	2.99%
3 month	3.28%	4 year	3.14%
4 month	3.26%	5 year	3.24%
5 month	3.24%	7 year	3.44%
6 month	3.23%	10 year	3.65%

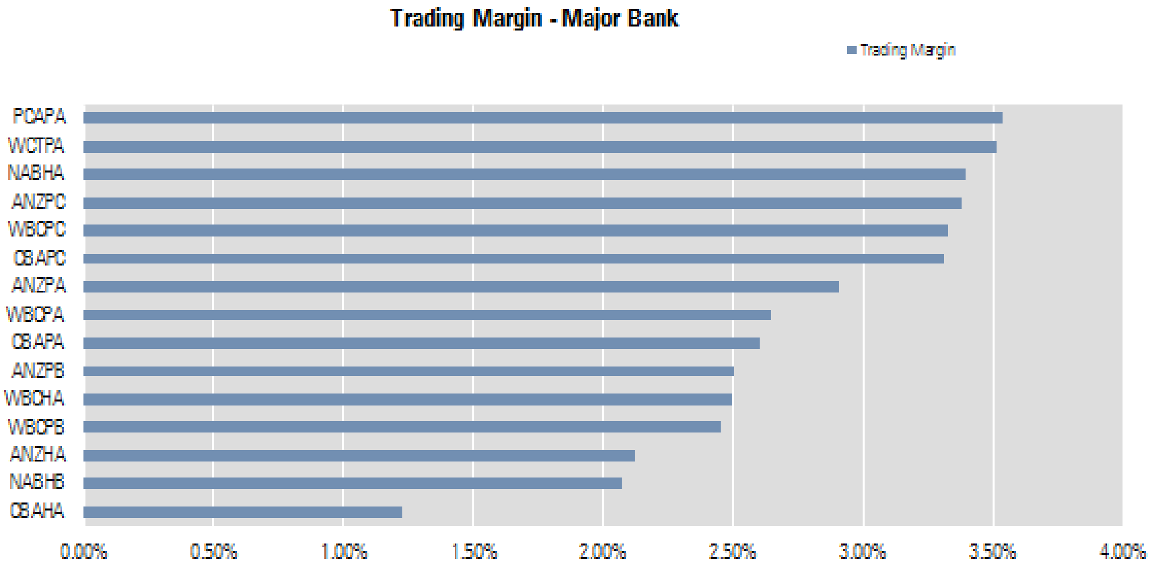
Source: Reuters

7. Major Bank Income Securities

- The past month saw some very interesting developments in the bank hybrid capital market. The primary factor was the decision by Bank of Queensland not to redeem BOQPC on its first call date. This is in direct contrast to a comparable issuer (Bendigo and Adelaide Bank) who did redeem BENPA at its reset date. This highlights the importance the issuer call option to investors. In the months leading up to the redemption date for BOQPC the price of these securities increased from ~$87 to $94 with an expectation that the securities would be called. Post the announcement that the securities would not be redeemed, the securities quickly retreated to a low of ~$85. Morningstar considers the issuers willingness to call these securities at their first optional call date as a very significant factor in its valuation. Investors should be cautious of issuers who do not act in the best interest of investors purely to remove risk from the issuers balance sheet. In December 2010 Morningstar re-initiated on BOQPC at a reduce recommendation primarily due to the fact that we did not believe the issuer would give holders the option to redeem for cash and the security would remain outstanding. This has proved to be true with the exception of the offer to reinvest in the new BOQ CPS hybrid.
- On 1 November 2012 Bendigo and Adelaide Bank (BEN) announced it had completed the bookbuild for its new Convertible Preference Share offer (ASX Code: BENPD), issuing $269m of Tier 1 capital at 180 day BBSW +5.0%. BENPD commenced trading on the ASX on the 8 November 2012 with the first dividend to be paid on the 13 December 2012. As part of the new security offer existing BENPA holders had the option to roll their investment into the new security but if they did not elect to reinvest BENPA securities were redeemed at par ($100) on 1 November 2012.
- On 19th November 2012 Bank of Queensland (BOQ) announced it had successfully completed the bookbuild for the BOQ Convertible Preference Shares (ASX Code: BOQPD). The issuer increased the size to $250m and priced the deal at 3M BBSW + 5.10% (the lower end of the range). This security does not fit within Morningstar's coverage eligibility criteria and hence will be covered. As part of the offer BOQ has offered holders, as at 9 November 2012, the option to convert into the new securities BOQ CPS (ASX Code: BOQPD).
- On 14 November 2012 the CBA announced that the High Court of Australia have overturned an earlier ruling in relation to the franking credits for PERLS V. The decision was in favour of the CBA and has no effect on PERLS V investors.

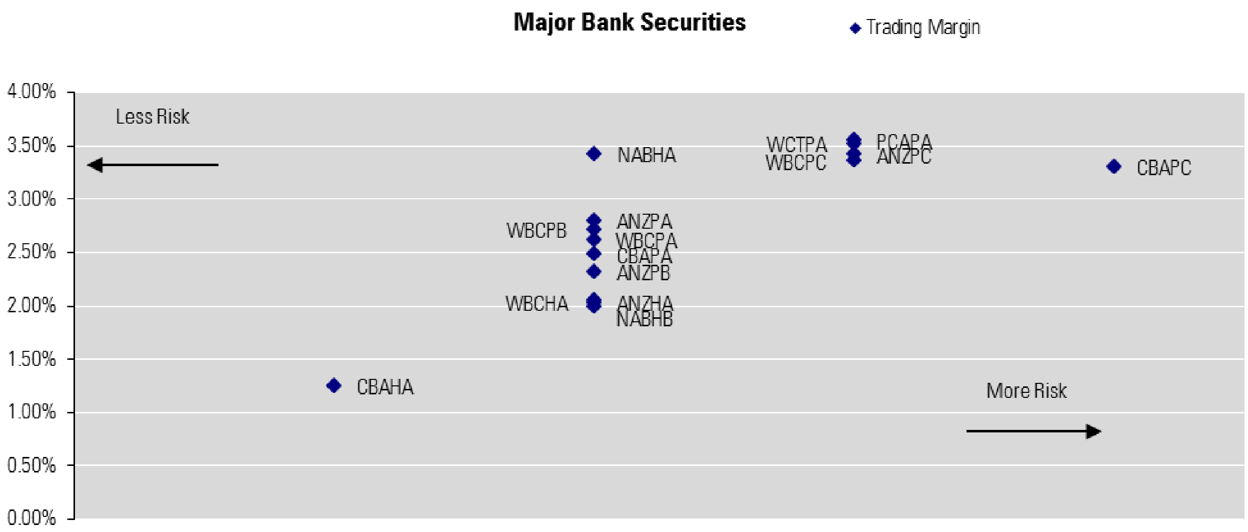
				Issue Size	Years To	Trading	Running Yield		Yield to Reset			
Code	Recommendation	Price($)	Issuer	($m)	Maturity	Margin	inc Fr	ex Fr	inc Fr	ex Fr	Dist ($)	Ex Date
ANZPA	ACCUMULATE	100.80	ANZ	1970	4.05	2.79%	6.47%	4.53%	6.20%	4.25%	1.16	ANZPA
ANZPB	ACCUMULATE	100.00	ANZ	1081	1.55	2.31%	5.90%	4.13%	5.70%	3.97%	1.05	ANZPB
CBAPA	ACCUMULATE	204.45	CBA	2000	1.93	2.47%	6.74%	4.72%	5.82%	3.69%	2.31	CBAPA
NABHA	ACCUMULATE	71.70	NAB	2000	-	3.42%	6.50%	6.50%	-	-	1.14	NABHA
PCAPA	ACCUMULATE	185.70	CBA	1166	3.36	3.54%	4.78%	3.34%	7.11%	5.62%	1.48	PCAPA
WBCPA	ACCUMULATE	100.70	WBC	1036	0.83	2.61%	5.82%	4.07%	6.08%	3.96%	0.00	WBCPA
WBCPB	ACCUMULATE	103.20	WBC	908	1.84	2.70%	7.13%	4.99%	6.02%	3.65%	0.00	WBCPB
WCTPA	ACCUMULATE	92.37	WBC	763	3.59	3.51%	4.76%	3.33%	7.09%	5.61%	0.00	WCTPA
CBAHA	ACCUMULATE	99.91	CBA	575	3.07	1.24%	4.43%	4.43%	4.60%	4.60%	1.07	CBAHA
ANZPC	ACCUMULATE	100.30	ANZ	1340	4.76	3.41%	6.60%	4.62%	6.83%	4.73%	2.27	ANZPC
ANZHA	HOLD	104.38	ANZ	1509	4.55	2.02%	5.98%	5.98%	5.36%	5.36%	1.53	ANZHA
WBCPC	ACCUMULATE	100.60	WBC	1189	5.34	3.35%	6.69%	4.68%	6.75%	4.66%	0.00	WBCPC
NABHB	HOLD	104.45	NAB	1173	4.56	1.98%	5.98%	5.98%	5.32%	5.32%	1.56	NABHB
WBCHA	HOLD	103.00	WBC	1676	4.74	2.04%	5.99%	5.99%	5.42%	5.42%	1.61	WBCHA
CBAPC	HOLD	104.10	CBA	2000	6.05	3.29%	7.09%	4.96%	6.71%	4.45%	0.79	CBAPC

Figure 7.1 Major Bank Income Securities – Trading Margins



Source: Morningstar

Figure 7.2 Risk vs. Trading Margins



Source: Morningstar

8. Other Floating-Rate Income Securities

- The hybrid market (ex-financials) had a quite month with no new issuance recorded. However, the market was disrupted by the announcement by Standard and Poor's that they would be changing their methodology for equity credit classification. In response Morningstar released a Special Report; "Corporate Hybrids: S&P's Review of Equity Credit May Impact Some of Our Recommendations". In this report we outlined the risks on specific listed income securities which may be affected by S&P's proposed changes to its methodology for determining whether to regard hybrid securities as equity or debt. This change has already been implemented for some recent income securities in Australia. It was evident with the inconsistent equity credit allocated to securities issued post June 2012 (i.e. CTXHA) vs. securities issued in the financial year ending June 2012 (i.e. TAHHB, ORGHA). While this structural change ran broadly under the radar. It has a unique effect on an issuer's credit profile and could potentially have an effect on the future performance of specific income securities. Morningstar has contacted the issuers and S&P about the changes and are in the process of reviewing our recommendation on ORGHA, AGKHA and TAHHB. We expect the review to be completed by the 30th November 2012.

				Issue Size	Years To	Trading	Running Yield		Yield to Reset		Dist	
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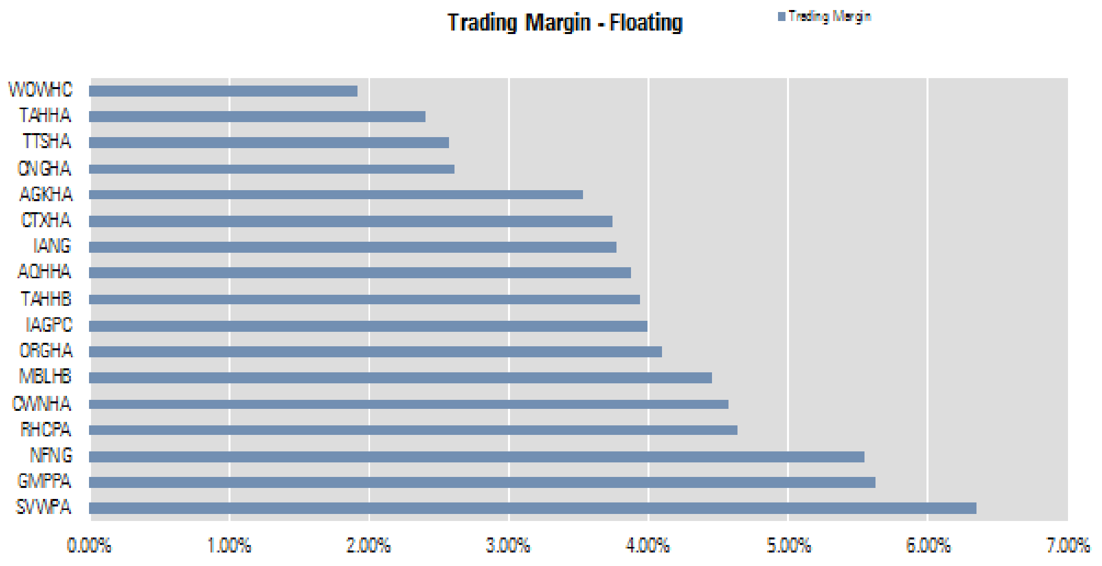
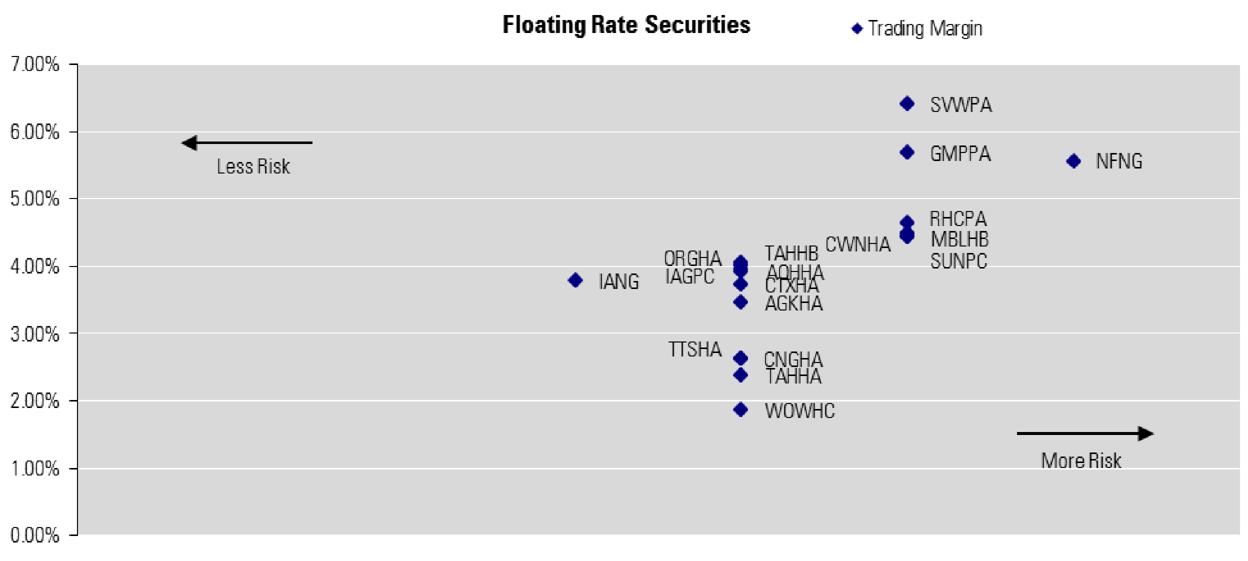
AGKHA	UNDER REVIEW	101.50	AGK	650	6.53	3.47%	7.15%	7.15%	6.92%	6.92%	1.84	26/11/2012
AQHHA	ACCUMULATE	103.90	APA	515	5.34	3.92%	7.83%	7.83%	7.44%	7.44%	2.30	17/12/2012
CNGHA	ACCUMULATE	103.50	CNG	1000	4.34	2.63%	6.54%	6.54%	6.01%	6.01%	1.65	17/12/2012
CTXHA	HOLD	104.90	CTX	550	4.80	3.72%	7.78%	7.78%	7.20%	7.20%	2.23	3/12/2012
CWNHA	ACCUMULATE	104.40	CWN	532	5.80	4.45%	8.33%	8.33%	7.93%	7.93%	0.00	30/11/2012
GMPPA	ACCUMULATE	93.65	GMG	327	5.09	5.69%	8.03%	8.03%	9.39%	9.39%	1.37	10/09/2012
IAGPC	HOLD	100.35	IAG	377	4.43	4.05%	7.45%	5.22%	7.44%	5.15%	2.48	17/04/2013
IANG	ACCUMULATE	102.75	IAG	550	7.05	3.78%	7.40%	5.18%	7.24%	4.90%	1.31	3/12/2012
MBLHB	ACCUMULATE	68.50	MQG	400	-	4.50%	7.56%	7.56%	-	-	1.23	20/12/2012
NFNG	ACCUMULATE	84.00	NUF	251	-	5.57%	8.86%	8.86%	-	-	4.05	28/03/2013
ORGHA	UNDER REVIEW	101.45	ORG	900	4.07	3.97%	7.48%	7.48%	7.44%	7.44%	1.84	10/12/2012
RHCPA	HOLD	103.70	RHC	260	-	4.64%	8.10%	5.67%	-	-	3.20	28/09/2012
SVWPA	ACCUMULATE	84.23	SVW	496	-	6.41%	9.77%	6.84%	-	-	2.81	9/11/2012
TAHHA	HOLD	102.90	TAH	284	1.42	2.39%	7.55%	7.55%	5.69%	5.69%	1.90	1/02/2013
TAHHB	UNDER REVIEW	101.30	TAH	250	4.32	4.01%	7.49%	7.49%	7.48%	7.48%	1.84	10/12/2012
TTSHA	ACCUMULATE	103.50	TTS	195	6.61	2.63%	6.37%	6.37%	6.03%	6.03%	1.62	20/12/2012
WOWHC	HOLD	105.20	WOW	700	3.99	1.86%	6.36%	6.36%	5.23%	5.23%	1.77	12/11/2012
SUNPC	ACCUMULATE	102.50	SUN	560	5.06	4.44%	8.11%	5.68%	7.93%	5.34%	0.61	3/12/2012

Figure 8.1 Floating Rate Income Securities – Trading Margins



Source: Morningstar

Figure 8.2 Risk vs. Trading Margins



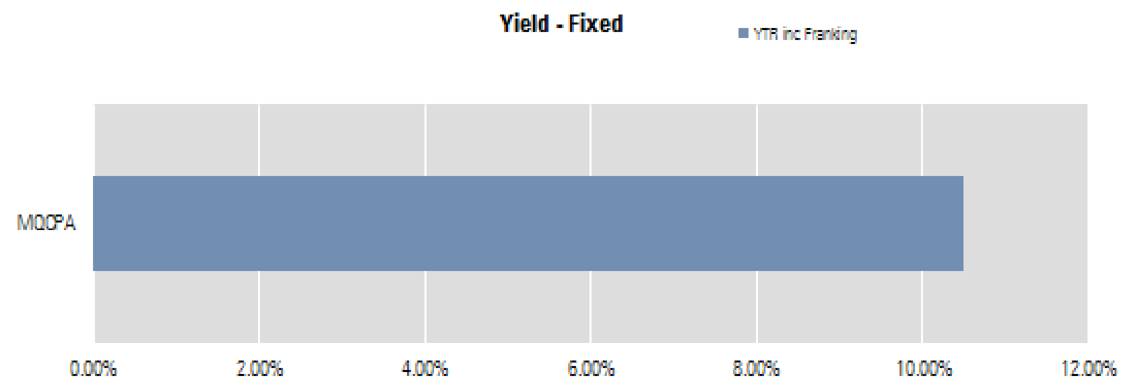
Source: Morningstar

9. Fixed-Rate Income Securities

- The universe for fixed rate securities is limited and not the focus for our coverage.
- Macquarie Group CPS (ASX Code: MQCPA) has rallied over the past few months primarily as a result of the rally in the underlying benchmark yield (government bond curve) not because the security is lower risk. This is the only fixed rate security remaining under our coverage and we expect that on the first option redemption date (30 June 2013) Macquarie Group (MQG) will redeem these securities for cash. This is subject to the conversion conditions (first being VWAP above $27.10). We believe it is unlikely that MQCPA will be converted as it will dilute the existing shareholder base by ~6% and following its first half results Morningstar slightly updated its fair value estimate on the ordinary share price primarily as a result of the completed share buyback in 1H2013. HOLD.

				Issue Size	Years To	Trading	Running Yield		Yield to Reset			
Code	Recommendation	Price ($)	Issuer	($m)	Maturity	Margin	inc Fr	ex Fr	inc Fr	ex Fr	Dist ($)	Ex Date
MQCPA	HOLD	104.90	MQG	600.00	0.60	-	11.40%	11.40%	10.50%	10.50%	5.53	15/12/2012

Figure 9.1 Fixed Rate Yields



Source: Morningstar

10. Glossary

BBSW	The Bank Bill Swap Rate (BBSW) is the average mid rate for Australian dollar bills of exchange accepted by an approved bank, having a tenor with a designated maturity, that appears on an approved information vendor's service (e.g., Reuters Screen BBSW page).
Conversion	Under certain circumstances, the hybrid security may be converted into a number of ordinary shares of the underlying stock at a specified conversion number, subject to terms, conditions and corporate events, including conversion discount, conversion date and triggers.
Conversion Discount	A discount in percentage applied to the underlying stock price into which the hybrid security may be converted. Also referred to as exchange discount.
Conversion Number	The number of ordinary shares of the underlying stock into which the hybrid security may be able to convert. For certain hybrid securities, there may be a minimum and/or a maximum conversion number applied. The conversion number is generally calculated based on a formula: Conversion Number = Face Value / [VWAP × (1 – Conversion Discount)]
Convexity	A measure for bonds used in conjunction with modified duration in order to measure how the bond's price will change as interest rates change. It is equal to the opposite of the second derivative of the bond's price relative to its yield, divided by its price. For example, since a non-callable bond's duration usually increases as interest rates decrease, its convexity is positive.
Cumulative	Depending on the hybrid security, the dividend, distribution or coupon paid may or may not be cumulative. If the dividend, distribution or coupon is cumulative and if the issuer defers the payment of the dividend, distribution or coupon on any payment date, then additional dividend, distribution or coupon will accrue at the prevailing distribution rate.
Dividend Yield	Expressed as a percentage, dividend yield is the company's annual dividend payments divided by its market cap, or the dividend per share divided by price per share.
Duration	The change in the value of a fixed-income security that will result from a 1% change in interest rates. Duration is stated in years. For example, a five-year duration means the bond will decrease in value by 5% if interest rates rise 1% and will increase in value by 5% if interest rates fall 1%. Duration is a weighted measure of the length of time the bond will pay out.
Exchange	Exchange means the conversion, redemption, buy-back or cancellation of the hybrid security.
Face Value	The face value of the security is the issue price typically being $100 per security.
Gross	Yield expressed, inclusive of any available franking credits or tax-deferred benefits.
Margin	Expressed as a percentage per annum, the margin offered by the hybrid security over a reference rate. The initial margin is typically determined by a bidding process within a prescribed margin range known as bookbuild. For certain hybrid securities, the margin may be increased (refer to Step-up) at a predetermined date.
Market Rate	See Reference Rate.
Mandatory Conversion	Some securities include a mandatory conversion condition, which forces conversion if the underlying stock price is above some threshold level and the issuer chooses not to redeem the security for face value.
Net	Yield expressed, exclusive of any available franking credits or tax-deferred benefits.
Reference Rate	Typically a floating reference rate (e.g., 90-day BBSW) used to reference the periodic coupon payment of a hybrid security. The reference rate is generally applied at the beginning of a distribution period for the upcoming distribution. Also referred to as the market rate.
Reset	For certain hybrid securities, on a reset date, the issuer may reset certain terms including the next reset date, the dividend/distribution rate, the conversion discount and the timing of frequency of dividend/distribution payments. Resets may mean significant change to the terms of the hybrid security and as a result investors may or may not accept such new terms. Further, the issuer may elect to redeem or to exchange the hybrid security. As such, Morningstar has a conservative approach to treating resets and considers it as a probable maturity. In tables and abbreviations, we use "Reset" to refer to any step-up, mandatory conversion, call or other pseudo-maturity event.
Running Yield	The hybrid's annual coupon payments expressed as a percentage of the market value of the security.
Step-up	For certain hybrid securities, the margin above the reference rate may be increased or stepped-up at a predetermined date upon the occurrence or non-occurrence of a certain event (e.g., non-conversion at a specified date).
Tax Deferred	The distribution of certain hybrid securities may have a tax-deferred component (may be less than 100%), which allows the distributions to be tax deferred over a certain period. The tax-deferred distributions are not assessable to Australian income tax upon receipt for most investors, but instead reduce the cost base of the security for capital gains tax purposes and as a result defer tax until the disposal of the security. Securities offering a tax-deferred component may give rise to tax benefits. Changes to tax legislation may have the effect of reducing the tax-deferred component of distributions. Investors should seek professional taxation advice in relation to dealing in these securities and their individual situation.
Time to Maturity/Reset	The time expressed in number of years from now to a reset date, conversion date, step-up date and/or maturity date, where on such date, either the terms of the security may change or the security may be repurchased, redeemed, exchanged or converted.
Trading Margin	In simple terms if an issuer already had securities on issue, they could expect any new securities with $100 face value to trade close to the trading margin. The Trading Margin of a security **s** is the effective margin at which **s** trades; it is the margin which a new security **n** with face value of $100 would need so the sum of the discounted cash flows of **n** equal the discounted cash flows of **s** assuming redemption of both **s** and **n** at the pseudo-maturity date of **s**. The calculation is grossed up for franking where appropriate.

VWAP	The average of the daily volume weighted average sale price of ordinary shares sold on ASX during the relevant period subject to specific terms and adjustments of the relevant hybrid security offer.
Volatility	The degree to which the price of a security tends to fluctuate.
Yield to Reset/Maturity (YTR/YTM)	The hybrid's internal rate of return to reset, step-up or other pseudo-maturity event.
pcp	previous corresponding period
p.a.	per annum
Capex	Capital expenditure
YoY	Year on Year
HoH	Half on Half
QoQ	Quarter on Quarter